

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 17196
[Redacted])	DECISION
)	
Petitioners.)	
_____)	

On December 30, 2002, the Income Tax Audit Division of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination to [Redacted] (taxpayers), asserting income taxes and interest in the amount of \$15,385 for the 1998, 1999, and 2000 taxable years. The taxpayers filed a timely appeal and petition for redetermination on February 26, 2003. An informal hearing was held in Boise, Idaho on June 4, 2003. The taxpayers, through their representative, provided some additional information at the informal hearing. During the conference, the taxpayers' representative was asked to provide more specific information to substantiate some of the taxpayers' Schedule C deductions. The taxpayers did not submit any further information for the Tax Commission to consider in making its final decision. The Tax Commission has reviewed the file and issues its decision affirming the Notice of Deficiency Determination based on the record now before it.

During the 1998 through 2000 taxable years, the taxpayers reported income and/or losses on the following three separate sole proprietorships: 1) [Redacted] mortgage broker [Schedule C filed for 2000]; 2) [Redacted] web builder and host [Schedule C filed for 1999 and 2000]; and 3) [Redacted] racing [Schedule C filed for 1998, 1999, and 2000].

The Commission's income tax audit staff disallowed a number of deductions claimed on the Schedule C businesses, and made several adjustments to the taxpayers' income tax returns for the periods in question. At the informal hearing, the taxpayers contested the following four

items: 1) Disallowance of expenses for [Redacted] for the 2000 tax year that the taxpayers claim was a rental expense; 2) Disallowance of expenses for [Redacted] for the 2000 tax year that the taxpayers claim were rental expenses; 3) Disallowance of undocumented telephone expenses for [Redacted]; and 4) Disallowance of all deductions claimed by [Redacted] racing.

1. Rent Expenses for [Redacted]

The audit staff disallowed \$8,931 of expenses for [Redacted] for the 2000 tax year. The taxpayers claim that this expense was for rent of the property located at [Redacted]. At the informal hearing, the representative of the taxpayers provided a letter from [Redacted] stating that “During the year 2000 [Redacted] paid the \$8,931 for rent at [Redacted].” No additional information or documentation was provided.

It is well established that the allowance of deductions is a matter of legislative grace and that a taxpayer has the burden of establishing his right to the deductions. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84, 112 S.Ct. 1039, 1043 (1992); *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 593, 63 S.Ct. 1279, 1281 (1943); *Deputy v. Du Pont*, 308 U.S. 488, 493, 60 S.Ct. 363, 366 (1940); *New Colonial Ice v. Helvering*, 292 U.S. 435, 440, 54 S.Ct. 788, 790 (1934). In this case, the taxpayers have not met their burden of establishing their right to the deduction of the rental expense. The letter is inadequate for the Commission to determine that the expense was in fact a rental expense for which taxpayers are entitled to a deduction. To substantiate their claim, the taxpayers would need to have provided documents such as cancelled checks, rental receipts, and/or a rental or lease agreement. Absent further documentation from the taxpayers, the Commission denies any adjustments to the taxpayers’ return regarding the disallowed rental expense.

2. Capital Asset Expenditures

After reviewing the Schedule C for [Redacted], the audit staff re-characterized several expenses as capital expenditures. The taxpayers contend that three of the re-characterized expenses should be treated as current expenses and not as capital expenditures. The auditor deemed payments to [Redacted] as capital assets and then depreciated them per Internal Revenue Code section 263A. The taxpayer contends that these items were actually rental payments.

[Redacted] appears to be an electronic retail outlet. [Redacted] develops software for the use of the Internet, and [Redacted] is a website design and hosting business.

At the informal hearing, the taxpayers were asked to provide documentation supporting their claim that these expenses were in fact rental payments. The taxpayers have not provided any information as to the nature of these purchases. Other than credit card bills, the taxpayers have not provided any receipts from [Redacted]. Thus, the taxpayers have not met their burden of establishing that these items are current expenses. Therefore, without further documentation from the taxpayers, the Commission disallows any adjustments to these items.

3. Telephone Expenses for [Redacted]

For the tax year 2000, the audit staff disallowed \$2,122 out of \$5,655 telephone expenses claimed on Schedule C for taxpayers' [Redacted] business because there was no documentation to support the deductions. The taxpayers' representative provided a Quicken spreadsheet of phone calls. This is a taxpayer generated document and is inadequate to substantiate the expenses. Again, the taxpayers have failed to meet their burden of proof for these deductions. Without further documentation to support the deductions, the Commission cannot make any adjustments to these items.

4. Snowmobile Racing

The taxpayers claimed losses regarding their snowmobile racing activities in the amounts of \$54,301 for 1998, \$15,797 for 1999, and \$19,670 for 2000. The audit staff determined that the enterprise was not a bona fide business and disallowed the claimed losses.

The taxpayers own several snowmobiles and engage in hillclimb competitions throughout the Rocky Mountain West. The taxpayers are called [Redacted] and are sponsored by [Redacted] which pays their entry fees to the hillclimb competitions. For sponsored riders, [Redacted] also allows a 20% discount on sled repairs and labor at their shop. This is a typical local retailer sponsorship arrangement for snowmobile racers.

Entry fees to the hillclimbs are under \$100 and vary according to whether the racer is racing semi-professional or professional. Prizes in the semi-professional race category consist of trophies, jackets, and other snowmobile paraphernalia. The professional racers can earn monetary prizes for placing first through fifth in a class. Although the taxpayers have not provided information as to whether they raced in the semi-professional or professional category, we assume for purposes of this decision that they were racing in the professional category. The taxpayers reported no income from their snowmobile racing activity in 1998, 1999, and 2000.

Under Internal Revenue Code section 183(a), the general rule is that an individual is not allowed a deduction for activities that are not engaged in for profit. The facts and circumstances must indicate that the taxpayers entered into the activity with the actual and honest objective of making a profit. Treas. Reg. 1.183-2(a).

To determine whether an activity is engaged in for profit, the following objective factors are considered: (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the

success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation. Treas. Reg. § 1.183-2(b). All facts and circumstances are to be taken into account in determining if the activity is for profit and no one factor is determinative. *Id.* The taxpayers bear the burden of proving that they possessed the required profit motive. *Welch v. Helvering*, 290 U.S. 111, 115, 54 S.Ct. 8, 9 (1933); *Golanty v. Commissioner*, 72 T.C. 411, 426 (1979).

The taxpayers have a general lack of documentation of the expenses for their snowmobile racing business. They did not supply any business books or records that would indicate that the snowmobile activity was a profit oriented venture. The taxpayers did not provide information regarding the possible monetary prizes from each of the hillclimb competitions, and they did not provide information regarding taxpayers' actual placements, winnings or point standings in the series of races.

At the informal hearing, the Commission asked the taxpayers to provide a list of the fees and expenses paid by [Redacted] in its sponsorship of Team [Redacted]. The taxpayers were also asked to provide specifics on the actual snowmobile or snowmobiles used by the taxpayers in their racing activities. The taxpayers did not supply any of this information. The general lack of documentation shows that the taxpayers did not conduct their snowmobile racing venture in a businesslike manner calculated to earn a profit.

The taxpayers did provide gas receipts, race schedules, and race repair receipts. However, the taxpayers did not indicate which races they actually attended. It appears from gas and meal receipts that not all races were attended. For example, in 1999, the race schedule shows seven hillclimb competitions, but based on dates and locations of gas purchases, the

taxpayers did not attend five of these races. In 1998, the race schedule shows eight races, but based on the location of meal receipts, the taxpayers did not attend half of these races. Thus, the taxpayers have failed to show that they committed a significant amount of time to their snowmobile racing endeavors.

Even if the taxpayers had no income from their racing activity, if the assets of the activity were appreciating, it may indicate they had a profit motive. However, in this case, snowmobiles are not appreciable assets.

During the tax years at issue, the taxpayers appear to have had substantial income from other sources. The losses generated by the snowmobile activity have generated substantial tax benefits to the taxpayers.

Viewing all the facts and circumstances from the record regarding taxpayers' snowmobile racing activities, it appears that the taxpayers did not undertake this business with an actual and honest objective of making a profit and that this activity was merely to reduce the taxpayers' income from other sources. The absence of formal business records, the recreational nature of the activity, the lack of income generated from the activity, and the lack of commitment to the activity show that the taxpayers did not engage in the snowmobile racing activity with a profit motive or objective.

WHEREFORE, the Notice of Deficiency Determination dated December 30, 2002, is hereby APPROVED, AFFIRMED AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayers pay the following taxes, penalty and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1998	\$4,755	0	\$1,710	\$6,465
1999	3,627	0	1,041	4,668
2000	3,823	0	792	<u>4,615</u>

TOTAL DUE \$15,748

Interest is calculated through December 31, 2003, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

DEMAND for immediate payment of the foregoing amount is made and given.

An explanation of the taxpayers' right to appeal this decision is enclosed with this decision.

DATED this _____ day of _____, 2003.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2003, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No.

[Redacted]
